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# Regional Trade Agreements and Implications for US Agriculture: The Case of CAFTA-DR

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At present the United States is actively engaged in twelve bilateral and five regional trade agreements or initiatives (Table 1). These agreements are designed to provide the United States with additional access to foreign markets and help foster positive relationships with trading partners. Among these is the Dominican Republic–Central American Free Trade Agreement (CAFTA-DR). Given the current debate on CAFTA-DR in the US legislature and the likelihood that the United States will negotiate future similar trade agreements, this paper is intended to provide an overview of CAFTA-DR and discuss its potential implications for US agriculture and agribusiness. The paper will also discuss implications for US imports by focusing on the case of the US sugar industry.

## Overview of the Agreement

The United States and five Central American countries—Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua—began negotiations for a Central American Free Trade Agreement (CAFTA) on January 27, 2003. President Bush notified the US Congress of his intent to enter into the CAFTA on February 13, 2004. If approved by Congress, CAFTA would most likely take effect in late 2005. Negotiations were concluded on March 15, 2004 that would fully integrate the Dominican Republic into the CAFTA, creating a Dominican Republic–Central American Free Trade Agreement (CAFTA-DR). In addition, negotiations are underway with Panama (Hornbeck, 2005).

The CAFTA-DR is intended to help enhance economic growth and improved living standards in the Central American region by reducing and eliminating barriers to trade and investment. CAFTA-DR converts the nonreciprocal and discretionary benefits that these countries get from the Generalized System of Preferences (GSP) and the Caribbean Basin Initiative (CBI) into permanent and reciprocal access to the US market. Though covering all trade, the agricultural component is one of the most important aspects of the agreement. The key to the agricultural agreement is market access, with relatively few provisions in the areas of export subsidies and sanitary and phytosanitary regulations. Domestic subsidies are not covered by the agreement.

The CAFTA-DR will create improved market opportunities for US agricultural products and related goods and services. Agricultural trade barriers in the Central American countries are higher than those for manufactured goods. The average bound tariff rates on US agricultural products entering CAFTA-DR vary by country from 35% in Honduras to 60% in Nicaragua. Although the applied rates are lower, in the range of 11–13%, they are not permanent and can be increased to the bound level without consultation with trading partners.

The role of CAFTA-DR is to reduce these high tariff rates to levels that will allow a freer flow of goods and services with the United States. CAFTA-DR locks in the lower applied rates for many products and ensures permanent US access to the market. However, the short-term impact on US exports of the CAFTA-DR may be modest, as the terms of the agreement are phased in over time, and for some commodities the commitments are backloaded. This means that the negotiated adjustments are postponed until some future date.[1]

Increased market access for Central American goods to the United States will also be a consequence of CAFTA-DR. However, the impact is likely to be limited, as most CAFTA-DR countries have had permanent duty-free access to the US market since the late 1960s under the

GSP and, since the 1980s, under provisions of the Caribbean Basin Initiative (CBI) and the Caribbean Basin Economic Recovery Act (CBERA) that implements the CBI. Approximately 99% of CAFTA-DR exports already enter the US market duty free. Duties are paid only on over-quota imports as part of the US tariff-rate quota regimes for sugar, dairy, cotton, meats, and peanuts.

The essence of a free trade agreement is to open up markets to greater access from partner countries. Given that most CAFTA-DR products already enter the United States duty free, the majority of US producers will not be harmed by increased imports. On the other hand, the opening up of new markets in the Central American region promises much in the way of benefits to US agriculture. However, these expectations must be tempered by the realities of the current level of economic development of the countries in the region. Of the CAFTA-DR partner countries, only Costa Rica and the Dominican Republic have incomes over $5,000 per person. Although US producers will benefit in the short term, additional future benefits will accrue as these economies expand.

## Strong Trade History

United States trade with CAFTA-DR countries has exhibited strong growth over the last decade. Total US merchandise exports to CAFTA-DR increased 74% from 1995 to 2004, reaching $15.7 billion in the latter year (including the Dominican Republic). US merchandise imports increased by 91% during the same period to $17.7 billion (United States International Trade Commission [USITC], 2005). US agricultural exports to CAFTA-DR countries increased 56%, from $1.09 billion to $1.71 billion over the same period, while US agricultural imports from the region have grown by 23%, from $2.01 billion to $2.47 billion (United States Department of Agriculture Foreign Agricultural Service [FAS], 2005). The trade deficit reflects the production of tropical products in Central America for the US market that exceeds their current purchases of temperate and Mediterranean goods from the United States.

Coarse grains, wheat, rice, soybean meal, tobacco, and other intermediate goods are major US exports to the CAFTA-DR countries. In 2004, these products accounted for 59% of US agricultural exports to the region. Wheat, soybeans, and rice are the major grain exports. Animal fats, poultry meat, and dairy products are the major animal and animal products exports. The major consumer-ready exports to CAFTA-DR are prepared fruits and vegetables, poultry meat, dairy products, snack foods, red meats, and fresh fruit. Although

**Table 1.** Current regional and bilateral free trade agreements involving the United States.

| Country/agreement | Date/status |
|---|---|
| **Israel** | 1985 (agricultural agreement 1996–2001) |
| **Canada** | 1986 (grandfathered into NAFTA) |
| **NAFTA (Mexico & Canada)** | 1994 |
| **Jordan** | 2001 |
| **Singapore** | 2004 |
| **Chile** | 2004 |
| **Australia** | 2005 |
| **CAFTA (Costa Rica, Honduras, Nicaragua, El Salvador, Guatemala)** | Negotiations concluded January 2004; awaiting submission of implementing legislation to US Congress |
| **Dominican Republic (added to CAFTA)** | Negotiations concluded March 2004; awaiting submission of implementing legislation to US Congress |
| **Panama (to be added to CAFTA)** | Negotiations began April 2004 |
| **Morocco** | Negotiations concluded in March 2004; implementation legislation passed US Congress; awaiting ratification by Moroccan Parliament |
| **Bahrain** | Negotiations concluded in May 2004; awaiting submission of implementing legislation to US Congress |
| **SACU (South African Customs Union: Botswana, Namibia, Lesotho, Swaziland, South Africa)** | Negotiations began in June 2003 |
| **Thailand** | Negotiations began in June 2004 |
| **Colombia, Ecuador and Peru** | Negotiations began in May 2004 |
| **Bolivia** | Expected to join Colombia, Ecuador, and Peru talks later |
| **Oman** | Notification to Congress of intent to negotiate, November 2004 |
| **United Arab Emirates** | Notification to Congress of intent to negotiate, November 2004 |

Note. Data from Office of the United States Trade Representative (2005) and public statements.

1. *A more detailed overview of the agricultural provisions of the agreement can be found at the website: http://www.ustr.gov/assets/Document_Library/Fact_Sheets/2004/asset_upload_file793_5328.pdf.*

bulk commodities account for the largest share of US exports, intermediate and consumer-ready products are becoming more prominent in CAFTA-DR countries (FAS, 2005).

Bananas and other fresh fruit, coffee, sugar, processed vegetables and fruit, and seafood are the major US imports from CAFTA-DR, accounting for 85% of US agricultural imports from the region in 2004. Bananas and plantains, avocadoes, pineapples, melons, fresh citrus, berries, okra, squash, tomatoes, fresh or frozen carrots, and various types of peas are among the most important fruit and vegetable imports from the Central American region (USDA/FAS). Given the trading history of the Dominican Republic and Central America with the United States, solidifying and increasing market access through CAFTA-DR will serve to strengthen trade relations and improve the economic welfare of each signator.

## The Impacts of CAFTA-DR

The key provisions in CAFTA-DR, as with most other trade agreements, are those that increase market access. US producers will be better able to sell into markets that reduce tariff barriers and others will have greater access to the US market. Along with tariff cuts come other aspects of market access: relaxation or reassignment of tariff-rate quotas (or their introduction when negotiated as a part of the agreement); trade remedies such as safeguards that limit market access in times of import surges; and other conditions that affect the cost of selling into a foreign market or that influence the costs of others selling into the US market.

CAFTA-DR countries already have preferred access for a wide range of goods under the CBI and also under the GSP. The impact of CAFTA-DR on these countries will be to grant them wider access, at least for sensitive products that have been excluded from the other market access schemes. They will, in effect, catch up with Mexico in term of access into the US market, except in one or two sectors such as sugar.

With respect to market access in the CAFTA-DR countries, US goods gain preference relative to those countries that do not have a free trade arrangement with CAFTA-DR members. This means that competitiveness is affected by the current trade agreements that these countries have with other countries. US suppliers would move (over a transition period) from supplying at most-favored-nation tariffs to having duty-free access. The advantage of this depends on which other suppliers already enjoy such privileges.

Consider the case of fresh grapes. Costa Rica imported approximately $3.9 million of fresh grapes in 2001. Over 70% of Costa Rica's fresh grape imports were supplied by the United States, followed by Chile with 27%. On October 18, 1999, Central America and Chile signed a free trade agreement. Thus, Chile enjoys duty free status for its fresh grape exports to Costa Rica. In this example, CAFTA-DR enhances US competitiveness relative to exporters such as Chile who previously enjoyed duty-free access. For trade in fruits, vegetables, and nuts, the USITC estimates that US imports will decline by 1.84% and US exports will increase by 14.23% after full implementation of CAFTA-DR.

## The Implications of CAFTA-DR for the US Sugar Industry

Implementation of the CAFTA-DR would allow an immediate expansion of the sugar and sugar-containing product imports into the United States from CAFTA-DR partners. This increase is in addition to their current access to the US sugar market. The duty-free tariff rate quota would initially increase by 109 thousand metric tons (tmt), increasing to 153.14 tmt over a 15-year phase-in with an increase of 2,000 metric tons each year thereafter. The additional market access is limited to either the specified amount or the net trade surplus for each country, whichever is smaller (USITC, 2004).

In addition to this agreement on market access for sugar, several related provisions were included in the agreement. The United States may provide compensation to its CAFTA-DR partners in place of the additional duty-free tariff-rate quota (TRQ) access. At the same time, although the United States is able to use certain price-based safeguard measures against sugar and sugar-containing product imports from other suppliers, the CAFTA-DR agreement does not allow the United States to use these measures against its CAFTA-DR partner countries (USITC, 2004).

The impact of additional US sugar imports on domestic raw sugar prices was estimated by Kennedy and Roule (2004) as a decrease from a base price of 20.66 cents per pound. As expected, the expansion of the US TRQ import levels resulted in a modest rise in world sugar prices. As shown in Table 2, the estimated impact of an additional 100 tmt alone—approximately the amount of additional imports allowed in the first year of the proposed CAFTA-DR agreement—would result in a reduction in US raw sugar prices of 0.63 cents per pound. In this scenario, domestic consumption, referred to in its raw sugar equivalent,

**Table 2.** Changes in prices and quantities resulting from alternative US market access scenarios.

| Additional imports from 2003/04 base (tmt) | Domestic price (¢/lb) | World price (¢/lb) | Beet production (tmt) | Cane production (tmt) | US consumption (tmt) |
|---|---|---|---|---|---|
| **Base** | 20.66 | 7.43 | 4,416 | 3,716 | 8,946 |
| **100** | 20.03 | 7.44 | 4,370 | 3,700 | 8,984 |
| **150** | 19.73 | 7.44 | 4,347 | 3,693 | 9,003 |
| **500** | 17.71 | 7.46 | 4,190 | 3,637 | 9,141 |
| **1,000** | 15.13 | 7.49 | 3,972 | 3,558 | 9,344 |
| **2,000** | 10.96 | 7.56 | 3,560 | 3,401 | 9,775 |
| **3,089** | 7.63 | 7.63 | 3,148 | 3,233 | 10,284 |

would increase by approximately 38 tmt, while beet and cane production would decrease by approximately 62 tmt.

In addition to the welfare impacts associated with changes in production and consumption, there will also be both job creation and reduction. The US sweetener industry has stated that it would stand to lose jobs as a result of increased imports. At the same time, sweetener-using industries have stated that they would likely increase their employment (USITC, 2004).

The combined impact of additional free trade agreements, such as the North American Free Trade Agreement, allowing for further increases in sugar importation into the United States, was estimated to be much greater. With a 500 tmt increase in US sugar imports, estimated world raw sugar prices increase slightly to 7.46 cents per pound, a less than 1% change from the base price. With a 3,000 tmt increase in US sugar imports, estimated world raw sugar prices increase to 7.62 cents per pound, an approximate 2.59% increase from the base price. However, these additional sugar imports resulted in a substantial decline in the US raw sugar price. A 500 tmt increase in US sugar imports was estimated to cause the US raw sugar price to drop below the loan rate to 17.71 cents per pound. A 3,000 tmt increase in sugar imports was estimated to cause the US raw sugar price to drop to world price levels of 7.86 cents per pound.

The tendency is that increased sugar imports will cause downward pressure on domestic prices in the absence of government intervention. When the government does intervene, as it currently does through the use of a nonrecourse loan, increased imports will increase the cost of maintaining the sugar program. As the US sugar industry faces increased pressure from the world market, the government faces the dilemma of how it can continue to support the sugar industry in light of the increased expense.

## Additional Implications

CAFTA-DR is a reflection of current trade policy of the United States, emphasizing the negotiation of bilateral trade agreements leading to freer trade with regional partners as well as keeping up the traditional support for further liberalization of the multilateral trade regime. The goal of the bilateral agreements with countries in the hemisphere is an eventual Free Trade Area of the Americas (FTAA).

The predominant feature of the CAFTA-DR itself is that most of the adjustment will fall on the Central American countries and the Dominican Republic; the United States has granted liberal access for exports from these countries for many years, whereas the United States has not had free access onto their markets. Tariffs on agricultural goods into these markets are still high, even though generally well below the rates bound in the WTO. The United States has insisted that reductions towards free access start from these applied rather than the higher bound rates. However, this does not mean that US exporters of farm products will be immediate gainers from the CAFTA-DR. The Central American markets are too small to be a lucrative prize for US business and agriculture. Moreover, access will only come over time. For some sensitive commodities, including agricultural goods, long transition periods of up to twenty years have been negotiated.

Adjustment costs in the United States are likely to be minimal. As a result, trade remedies are less central to the FTAA from the viewpoint of the United States. Surges of imports from the Central American region are unlikely, and any market growth will be a result of the increasing sophistication of exporting firms in the region rather than the changes in trade barriers. Accordingly, trade remedy arrangements are unlikely to be used, in contrast to the situation with Mexico a decade ago, when imports under NAFTA of some products increased rapidly. However, import surges are of concern to the countries of Central America and the Dominican Republic. The trade remedies specified in the CAFTA-DR complement the long transition period and the gradual expansion of tariff-rate quotas.

## For More Information


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